

Municipalities maintain reserves in order to provide budgetary flexibility for unexpected events, to withstand financial emergencies and to protect the municipality from the usual unevenness in revenue-expenditure patterns. The Government Finance Officers Association recommends that local governments maintain reserves (unreserved fund balance) of 5-15 percent of general fund revenues, depending on the needs of the community.

Reserves are generally established in three categories:

- **Contingency Reserve:** A reserve for unforeseen events;
- **Unrestricted Reserve:** A reserve that can be used for any purpose; and
- **Restricted Reserve:** A reserve dedicated for specific use at some future time.

Reasons for Creating and Maintaining Reserves

A review of the public finance literature generally reveals five reasons local governments create and maintain reserves:

1. **Operational Needs** –These are contingency reserves which are typically appropriated as part of the annual budget. The purpose is to meet unexpected increases in department operational costs such as legal fees, major equipment repairs and snow removal.
2. **Catastrophic or Emergency Expenditures** – These are contingency reserves which provide emergency funds for use in a major calamity such as a hurricane, blizzard, uninsured loss or damage to a capital asset.
3. **Maintenance of Assets** – These are restricted reserves used to replenish the continuing depreciation or replacement of buildings and equipment. Beginning with the FY03 Audit, the Town was required to show the depreciation of certain fixed assets.
4. **Liquidity or Cash Flow:** These are unrestricted reserves used to reduce the need for short-term borrowing, generate investment income and to maintain a strong credit rating.
5. **Unfunded Liabilities:** These are restricted reserves used to fund an unfunded liability that has been incurred during the current or prior years, but which does not have to be paid until a future year, and for which adequate reserves have not been set aside. These liabilities may not be apparent in typical financial records in a way that makes their impact easy to assess. This type of liability accumulates gradually over time and may go unnoticed until it has created severe financial problems. Unfunded liabilities are predominantly post-employment benefits.

Goals

Goals are broad, fairly timeless statements of the financial position the Town seeks to attain. The financial goals for the Town of Upton are:

- To provide full value to the residents and business owners of Upton for each tax dollar by delivering quality services efficiently and on a cost-effective basis

TOWN OF UPTON RESERVE POLICY

- To preserve our quality of life by providing and maintaining adequate financial resources necessary to sustain a sufficient level of municipal services, and to respond to changes in the economy, the priorities of governmental and non-governmental organizations, and other changes that may affect our financial well-being
- To improve the Town's credit rating to the highest practical level
- To guide all Town boards and committees on management and policy decisions which have significant financial importance
- To set forth operating principles that minimize the cost of government and financial risk
- To employ balanced and fair revenue policies that provide adequate funding for desired programs
- To maintain appropriate financial capacity for present and future needs
- To promote sound financial management by providing accurate and timely information on the Town's financial condition; and
- To ensure the legal use of financial resources through an effective system of internal controls.

General Fund Priorities

- A. Budget Goals and Objectives shall be determined annually by the Board of Selectmen in consultation with the Town Manager and Finance Committee. However, the annual operating budget as submitted to the Town must be balanced with the estimate of proposed expenditures for a given period less than or equal to the proposed means of financing these expenditures (from various sources of funds or revenues). In short, for a budget to be balanced, proposed expenditures shall not exceed projected resources for the given period.
- B. The Town will carefully and routinely monitor all amounts due the Town. An aggressive policy of collection will be followed for all receivables, including property taxes. An average collection rate of at least 96% of current levy shall be maintained.
- C. Charges for services and other revenues shall be reviewed on a regular on-going basis at least every three years. Charges shall be adjusted as necessary to respond to changes in the cost of providing services.

Reserve Policy

It is recommended that the Town of Upton establish the following Reserve Policies and target dates for financial reserves:

1. Reserve: Finance Committee Reserve Fund (For Unforeseen and Extraordinary Events)

| | |
|----------------------|---|
| Statutory Reference: | MGL Chapter 40 § 6 |
| Type of Reserve: | Contingency and Unrestricted |
| Proposed Reserve: | .50 percent of the prior year adjusted general fund operating budget |
| Current Year Approp: | \$20,000 |

TOWN OF UPTON RESERVE POLICY

Uses: For extraordinary and unforeseen events, as determined by vote of the Finance Committee.
Target Date: This reserve policy is not being met.

2. Reserve: Stabilization Fund

Statutory Reference: MGL Chapter 40 § 5B
Type of Reserve: Contingency, Unrestricted, May be Restricted by vote of Town Meeting.

Proposed Reserve: \$1,758,000 or 10% of Annual Operating Budget.

Current Balance: **Currently the Town is at 7.2%.**

Uses:

1. An appropriation from the Stabilization Fund may be requested if State Aid payments are reduced from estimates after the budget is voted by Town Meeting;
2. An appropriation from the Stabilization fund may be requested if net State Aid, receipts (excluding SBA) less assessments, is less than the average of the prior two fiscal years.
3. An appropriation from the Stabilization Fund may be requested if local receipts are projected to be less than the average of the prior three fiscal years. The amount to be requested from the Stabilization Fund would be in an amount to offset the three-year local receipts reduction.
4. An appropriation from the Stabilization Fund may be requested for catastrophic or emergency events if the financial impact of the event is in excess of an amount which the Finance Committee Reserve Fund can fund.

All appropriations into and out of the Stabilization fund require a vote of Town Meeting.

Target Date: Achieve reserve level by fiscal year 2018 by adding 10% of each year's certified Free Cash. Reserves reflect a community's ability to react to unforeseen circumstances and to minimize or avoid borrowing for capital expenditures. Reserves should normally average between 5% and 10% of the Town's General Fund (operating budget) expenditures. The Town will endeavor to maintain reserves at 10% of General Fund Expenditures. Reserves are defined to include the Town's Stabilization Fund and Free Cash.

3. Reserve: Post-Employment Benefits Reserve – Unfunded Liability

Statutory Reference: May be a Chapter 40 § 5B (Stabilization Fund) Account
Type of Reserve: Restricted

TOWN OF UPTON RESERVE POLICY

Proposed Reserve: \$4,298,116 (Pay as you go). A Post-Employment Benefits Trust Fund was established in FY 2011 at \$5,000 and has been increased by \$10,000 in FY12, and \$15,000 in FY 13. Contributions must continue annually until an actuarial funding level is reached.

Current Balance: \$30,000

Uses: To fund future post-employment health benefits due retirees.

Target Date: To be determined.

4. Reserve: Overlay Reserve for Abatements

Statutory Reference: MGL Chapter 59 § 25, 70A

Type of Reserve: Contingency

Proposed Reserve: When the use of this reserve is required, the Board of Assessors will vote to release funds to the Overlay Surplus account to be used for the stated purpose.

Current Balance: \$422,725.34

Uses: To fund the overlay account beyond typical amounts and to fund overlay deficits

Target Date: _____.

Other Reserves the Town might consider adopting in the future:

1. Unused Tax Levy Capacity (new growth)

Statutory Reference: MGL Chapter 59 § 5

Type of Reserve: While not a true reserve, unused tax levy capacity would be considered an unrestricted revenue source.

Proposed Reserve: Adopt a practice of not appropriating at the Annual Town Meeting new growth in the tax base in order to maintain unused levy capacity for the uses stated below. Unused levy capacity should be used in conjunction with the Stabilization fund, as noted below.

Current Balance: None.

Uses:

1. Unused levy capacity will be used to offset any snow and ice deficits from the prior year.
2. Prior to Annual Town Meeting, some unused levy capacity may be used in revenue estimates if local receipts are estimated to be less than the average of the prior three years. Unused levy capacity may also be used to offset any estimated local receipt shortfall in making the tax rate setting calculation.
3. Unused levy capacity may be used prior to appropriating from the Stabilization Fund, as outlined in this Policy.
4. Prior to Annual Town Meeting, some unused levy capacity may be used in revenue estimates after taking into consideration other uses previously stated.

TOWN OF UPTON RESERVE POLICY

Target Date: None.

It has been the Town's practice to maintain unused levy capacity each year in an amount approximately equal to the amount of additional tax levy due to new construction.

Free Cash Policy

Free Cash reserves are the remaining, unrestricted funds from operations of the previous fiscal year; these include unexpended Free Cash from the previous year, actual receipts in excess of revenue estimates and unspent amounts in budget line-items. Once certified, monies held in this reserve may be appropriated during the current budget year and may also be used as a source of revenues for the ensuing budget year.

The Town has historically used some portion of its Free Cash to subsidize the annual operating budget during the fiscal year for unforeseen expenses. However, it is the Town's goal to limit the amount of Free Cash used in the operating budget to a sustainable level and to use these available funds to bolster stabilization funds, OPEB reserves, and for non-recurring one-time expenses, such as capital items.

For purposes of this policy, the following are deemed to be appropriate uses of Free Cash:

- Appropriated Reserve – an amount to provide for extraordinary or unforeseen expenditures as authorized by MGL Chapter 40, Section 6.
- Operating Budget – the Town will limit its use of Free Cash to unforeseen and/or emergency purposes that can't be addressed with the Finance Committee reserve. An example of this would be to cover unanticipated snow and ice deficits.
- Stabilization Fund – to fund or replenish the Stabilization Fund.
- Capital Improvement Program – to fund capital projects that would otherwise incur borrowing costs associated with the issuance of debt.
- Special Use – to augment the trust funds related to fringe benefits and unfunded liabilities related to employee fringe benefits (Other Post-Employment Benefits).
- Extraordinary Deficits – to fund any potential deficits that would otherwise be carried over to the following fiscal year.
- Emergency Appropriations – to allow for fiscal flexibility.

TOWN OF UPTON RESERVE POLICY

The benefits of a Free Cash Policy are:

- Creates a principle-based decision making process that establishes clear, agreed upon priorities and expectations with regard to the use of Free Cash.
- Links one-time revenues to one-time expenses and provides an appropriate funding source for capital projects, especially small pay-as-you-go equipment purchases.
- It strengthens the Town's overall financial position by lowering our reliance on one-time revenues in the operating budget, provides for adequate financial reserves, eliminates financing costs for small projects, and increases flexibility and lead time to address significant changes in economic conditions.
- Strengthens our bond rating; thereby lowering interest cost on future debt.

The priority for use of Free Cash during the fiscal year shall be as follows:

- Make a contribution to the General Stabilization Fund of 10% of Free Cash until a 10% threshold of all stabilization accounts is achieved.
- Make a contribution of 5% of each year's Free Cash to the OPEB Trust fund in order to reach the actuarial accrued liability.
- Fund as much of the Town's Capital Improvement Program as is achievable within the amount of Free Cash available.

The overall level of Financial Reserves is critical to maintaining the Town's Bond Rating and ensuring sufficient funds to manage unanticipated needs. Funds shall be allocated from Reserves only after an analysis has been prepared by the Town Administrator and presented to the Board of Selectmen. The analysis shall provide sufficient evidence to establish that the remaining balance is adequate to offset potential downturns in revenue sources and provide sufficient cash balance for daily financial needs.

APPROVED BY:

Board of Selectmen, Chair: James A. Brochu _____

Board of Selectmen: Robert J. Fleming _____

Board of Selectmen: Kenneth E. Picard _____

Original date: August 20, 2013

TOWN OF UPTON RESERVE POLICY

Data Table

Finance Committee Reserve: FY 13/14:

Stabilization Funds:

| | | |
|-----------|------------------------|----------------|
| FY 13/14: | School Stabilization: | \$ 546,058.95 |
| | General Stabilization: | 532,941.41 |
| | Capital Stabilization: | 188,560.67 |
| | Water Stabilization: | 825.75 |
| | Wastewater Stabiliz: | <u>183.49</u> |
| | Total: | \$1,268,570.27 |

Post-Employment Benefit Reserve (OPEB):

| | |
|-----------|-----------|
| FY 13/14: | 30,000.00 |
|-----------|-----------|

Overlay Reserve:

| | |
|-----------|--------------|
| FY 13/14: | \$422,725.34 |
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